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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ALLIED CENTRAL STORES, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Allied Central Stores, Inc., respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on December 17, 1964.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States are not officially reported but are unofficially reported at 23 T.C.M. 248 and ¶ 64-045

P-H Memo. T.C. The opinion of the Court of Appeals has not yet been officially reported but is unofficially reported at 65-1 U.S.T.C. ¶ 9123. As required by Rule 23, a certified copy of the transcript of proceedings below and of the Appendix record of the proceedings in the Tax Court of the United States together with nine additional copies of the latter is separately submitted herewith. The opinion of the Court of Appeals is printed hereinafter in Appendix A hereto.

JURISDICTION

The judgment of the Court of Appeals was entered on December 17, 1964. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTIONS PRESENTED

I. Whether under the decision of this Court in *Libson Shops, Inc.* v. *Koehler,* 352 U.S. 382 (1957), a single corporation which is continuously engaged in conducting one substantial business activity must be deprived of its statutory right to a net operating loss carryover, to which it would otherwise admittedly be entitled under section 23(s) and 122 (b)(2)(B) of the Internal Revenue Code of 1939, merely because it acquires by statutory merger assets of a commonly-owned corporation engaged in exactly the same business, where both the merging corporation and the surviving corporation were 100% owned subsidiaries of a common parent for a great number of years.

II. Whether the provisions of the Internal Revenue Code of 1954 or the provisions of the Internal Revenue Code of 1939 apply with respect to petitioner's net operating loss for its fiscal year ended January 31, 1954. If the provisions of the Internal Revenue Code

of 1954 apply, whether the decision of this Court in *Libson Shops, Inc.* v. *Koehler, supra,* bars use of taxpayer's 1954 loss against its 1955 and 1957 income.

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are section 23(s) and 122(b)(2)(B) of the Internal Revenue Code of 1939 and sections 172, 381, 382, 393, 394 and 7851 of the Internal Revenue Code of 1954. These provisions are set forth in pertinent part in Appendix B, pages 5a to 17a, *infra.*

STATEMENT OF THE CASE

Petitioner sustained net operating losses in the operation of its business for fiscal years ended January 31 as follows:

1951	$ 1,377.99
1952	404,932.25
1954	93,589.84
1956	249,681.92

The petitioner's net taxable income, before the deduction of any net operating loss carryovers or carrybacks, was determined by the Commissioner of Internal Revenue for fiscal years ended January 31 to be as follows:

1955	$243,371.77
1957	315,989.24

For the fiscal year ended January 31, 1953, the petitioner filed a consolidated return of income with its parent, Allied Stores Corporation, and other controlled subsidiaries of the parent. Upon such a consolidated return, the losses of 1951 and 1952 were not allowable as a deduction. The petitioner had no taxable income

for 1950 against which losses of 1951 and 1952 might have been applied as a carryback.

The petitioner was organized on February 27, 1939, as a wholly-owned subsidiary of Allied Stores Corporation. The parent corporation was organized in 1928 to establish and operate a nation-wide chain of department stores. It has conducted its business in part through the ownership and operation by it of department stores and in part through subsidiary corporations owned and controlled by it. Its stock was publicly owned and for many years prior to and including all years here involved was listed upon the New York Stock Exchange.

Upon its organization, Allied Stores Corporation acquired, among others, all of the capital stock of L. S. Donaldson Company and of The Golden Rule. In 1940, it acquired all of the capital stock of Heers, Inc. Each of the corporations named, including the petitioner and the parent corporation, were engaged in the operation of department stores.

On the dates stated, the corporations named were merged into the petitioner as follows:

October 31, 1953, Heers, Inc.
September 30, 1956, L. S. Donaldson Company
September 30, 1956, The Golden Rule

In each merger the petitioner was the surviving corporation. Subsequent to the merger and through the taxable year 1957 the petitioner continued to operate its original store and the stores previously operated by the merged corporations. At all times since its organization, the petitioner has been one of the wholly-

owned subsidiaries of Allied Stores Corporation and controlled by it.

Upon organization, the capital stock of petitioner consisted of 50,000 shares of common of the par value of $1 each and 3,000 shares of preferred of the par value of $100 each. This capitalization remained unchanged throughout all periods here involved. On financial statements included in tax returns, the assets and liabilities of the petitioner were increased by those of the merged corporations and the stated capital and surplus of the merged corporations were added to the surplus of the petitioner.

The corporate name of the petitioner was changed to Allied Stores of Missouri on October 31, 1953, when Heers was merged into it, and to Allied Central Stores, Inc. on September 30, 1956, when Donaldson and Golden Rule were merged into it.

Petitioner utilized its losses for 1951, 1952 and 1954 against its profits for 1955 and 1957 in its tax returns. The Commissioner, citing *Libson Shops, Inc.* v. *Koehler, supra,* disallowed the claimed net operating loss carryover deductions. Petitioner sought a redetermination of the resulting deficiency for fiscal year 1957 before the Tax Court of the United States on the grounds that the *Libson Shops* doctrine did not bar carryover of the losses from 1951, 1952 or 1954 under section 122 of the Internal Revenue Code of 1939 and in the alternative that carryover of the 1954 loss was governed by section 172 of the Internal Revenue Code of 1954 which the *Libson Shops* doctrine has no application. The Tax Court, in a memorandum opinion which was not reviewed by the full Court, upheld the Commissioner's determination on both issues. On the first

issue, the Tax Court memorandum opinion held that even though the same entity with the same owner was involved, the *Libson Shops* doctrine required that pre-merger losses could only be offset against income generated by the same assets which generated the losses and since taxpayer could not prove how much of the later income was attributable to the assets which generated the earlier losses, no carryover was allowable. In considering the second issue, the opinion indicates that the wrong statute was relied on by the Tax Court. The Court of Appeals for the Second Circuit upheld the Commissioner and the Tax Court. On the first issue, the opinion relies solely on the Second Circuit's earlier decision in *Julius Garfinckel & Co., Inc.* v. *Commissioner,* 335 F. 2d 774 (2d Cir. 1964), cert. denied ... U.S. ... (1965) without making any real effort to deal with the substantial differences between the two cases. The Court as an afterthought suggests that one may have to look to the possibility of changes of ownership of petitioner's parent because its stock is listed on the New York Stock Exchange to determine whether there is continuing ownership of the loss corporation. On the second issue, the Court of Appeals concluded that *Libson Shops, Inc.* v. *Koehler, supra,* applies to fiscal years ending after December 31, 1953 at least until June 22, 1954 when in the opinion of the Court sections 381 and 382 of the Internal Revenue Code of 1954 became applicable to mergers.

BASIS FOR JURISDICTION IN THE LOWER COURTS

Jurisdiction of the Tax Court of the United States rests on 26 U.S.C. § 6214. Jurisdiction of the Court of Appeals for the Second Circuit rests on 26 U.S.C. § 7482.

REASONS FOR GRANTING THE WRIT

There are three basic reasons why a writ should be allowed in this case.

1. The decision of the Second Circuit in this case erroneously decides a question of continuing importance both under the Internal Revenue Code of 1939 and under the Internal Revenue Code of 1954.

2. The decision is in direct conflict with the recent decision of the District Court for the Middle District of Georgia in the case of *Jackson Oldsmobile, Inc.* v. *United States*, ... F. Supp. ... (M.D. Ga. 1964), 65-1 U.S.T.C. ¶ 9113 (M.D. Ga. 11/13/64).

3. If the decision below is correct, it makes a mockery of sections 381 and 382 of the Internal Revenue Code of 1954.

ARGUMENT

1. Petitioner's case presents the Court with a timely opportunity to settle several important questions concerning the application of and limitations on the Libson Shops decision under both the 1939 and 1954 Codes.

It has been almost eight years since this Court decided *Libson Shops, Inc.* v. *Koehler, supra.* During that time, fully 36 cases have been spawned, litigating various ramifications of the *Libson Shops* continuity of business enterprise theory. Most of these cases have involved various aspects of the question specifically reserved from judgment in now-famous footnote 9 of the *Libson Shops* opinion. The Internal Revenue Service has issued several rulings in an effort to interpret the theory and to give some bounds to it, but its rulings have been contradictory and confusing. This Court has thus far steadfastly refused to give guidance toward resolution of the important issues still outstand-

ing. The confusion has been generated not only in application of the theory to situations clearly within the facts of the *Libson Shop* case[1] but has arisen also because of the interpretation the Internal Revenue Service has given the decision and because of the attempt by the Service to extend the doctrine beyond the facts in that landmark case.[2]

The *Libson Shops* case involved a merger of 16 corporations owned and controlled by individual shareholders into a separate management corporation also owned by the same individual shareholders. Three of the merging corporations had net operating losses prior to the merger. This Court held that regardless of whether the surviving corporation was the "same entity" as the merging corporations, there was no continuity of business enterprise which would justify carryover of the pre-merger losses against post-merger profits. Footnote 9 expressly reserved judgment on

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[1] Neither the Internal Revenue Service nor the courts have given any guideline as to how profits of a particular segment of a taxpayer's business are to be applied against prior losses of that "business" when it was a separate entity. The only statutory rule is found in section 172 which deals with income and losses of taxpaying entities—not income or losses of a particular "business" operated by a taxpayer. This Court's pronouncement in *Libson Shops, supra*, cuts across the only statutory rule provided. Furthermore, no guideline has been issued by anyone as to how to determine the profits attributable to a particular "business", i.e., allocation of overhead, general expense, etc. It was not until 1959 when the Internal Revenue Service stated that taxpayers should maintain records from which income and expenses of the "business" could be derived. Rev. Rul. 59-395, 1959-2 Cum. Bull. 475, 479. This was two years after *Libson Shops* and six years after the transactions in question here.

[2] It is probably safe to say that more has been written about the *Libson Shops* decision than any other single tax case in recent years.

cases involving a single corporate entity which changes its business activities.

The Government in the cases since *Libson Shops* has taken the position that *Libson Shops* requires that net operating losses can only be carried over against income generated by the very same assets which generated the losses even in cases involving no change in the corporate entity and no change of ownership, as the Government's position in petitioner's case indicates. The Commissioner has thus attempted to push the *Libson Shops* concept far beyond any logical application. In doing so, the Commissioner has tended to defeat the original intent of Congress in adopting the loss carryover provisions.

The Commissioner's approach is that the net operating loss carryover and carryback provisions are some sort of special tax advantage to be narrowly construed. Far from it, these provsions were added to ameliorate the obvious injustice of application of the annual accounting concept in cases involving business losses during some periods and profits during others. Most businesses are expected to and do incur losses during at least some portion of their economical existence, especially in the early stages of development. Losses are in part sustained so that profits can be later earned. It is obviously unjust not to match the business losses against the resulting income. The net operating loss deduction is not special privilege legislation but is recognition of an obvious economic fact of life for most businesses. It was designed to offset an obvious, unjust tax detriment. The Board of Tax Appeals a number of years ago in *Northway Security Company* v. *Commissioner,* 23 B.T.A. 532, 535, (1931), pointed out that the carryover provisions were intended to be "relief"

provisions which should be liberally construed. It was only after people began abusing use of the carryover right by trading in loss carryovers that a restrictive view of the statuory right has become noticeable. It should be noted that where a single corporation is involved with the same ownership before and after any change in business takes place, there is no trading in loss carryover. This is the situation in petitioner's case.

As pointed out in *Norden-Ketay*:

> "Where there is a continuity of ownership, there might be justice in allowing a loss carryover even though there has been a complete change in the nature of corporate activity. The purposes of the statute are ultimately directed toward granting a legitimate tax advantage of the shareholders behind the corporate entity. See *Newmarket Manufacturing Company* v. *United States*, 233 F. 2d 493, certiorari denied, 353 U.S. 983 (1957)."

And again, as noted by Judge Aldrich in his penetrating dissenting opinion in *Collins* v. *United States*, 303 F. 2d 142, 149 (1st Cir. 1962):

> "But I might observe that I seriously question the correctness of the District Court's handling of *Libson Shops*. The subsequent lower court cases which have been decided against the taxpayers involve the change of ownership of the company along with the change in business. It would be one thing to prevent trading in tax losses by preventing a new party from acquiring a built in tax loss for a new business, but something else to say the taxpayer who has himself incurred a bona fide loss must lose the deduction if he changes the nature of his business."

It was obviously considerations such as these which gave this Court pause and prompted reservation of

judgment in the situations enumerated in footnote 9 to the *Libson Shops* opinion which stated:

> "9. We do not pass on situations like those presented in *Northway Security Company* v. *Commissioner*, 23 B.T.A. 532; *Alprosa Watch Corporation* v. *Commissioner*, 11 T.C. 240; *A. B. & Container Corporation* v. *Commissioner*, 14 T.C. 842; *WAGE, Inc.* v. *Commissioner*, 19 T.C. 249. In these cases a single corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credit of another."

A. B. & Container Corporation and *Alprosa Watch Corporation* both involved a complete change of ownership and business activity. In *Northway Security Company*, the loss corporation sold its assets, changed its name, moved its office to another state and proceeded to engage in another business. There was no change of stock ownership. The Board of Tax Appeals in allowing the loss carryover characterized the carryovers provision as a relief provision which should be liberally construed. A similar situation is found in *WAGE Inc.* where a corporation engaged in selling cars changed its name and acquired a profitable radio broadcasting business as a result of a merger. The resulting corporation terminated the unprofitable automobile business four months after the merger. The Tax Court allowed the continuing corporation to carry over its unused excess profits tax credit incurred in the automobile business against the later radio broadcasting profits.

Petitioner's case involves the very situation which this Court must have had in mind in footnote 9. Here there is a *single* corporation with a *single* owner and

carrying on essentially the *same* business but on a larger scale after the change than before. There has been no trading in loss carryovers to give someone who has not economically borne the loss a "windfall".

While there have been numerous opportunities before this Court to resolve various questions reserved in footnote 9, the Court has not heretofore seen fit to consider any of them. For example, in the early case of *Mill Ridge Coal Company* v. *Patterson*, 264 F. 2d 713 (5th Cir. 1959), cert. denied 361 U.S. 816 (1959), a situation similar to *A. B. & Container Corporation* and *Alprosa Watch Corporation* arose. In the *Mill Ridge Coal Company*, the loss corporation sold off its coal assets and entered into a new oil transport business. It sought to offset its coal business losses against its oil transport business income. The District Court and the Fifth Circuit held there was no continuing business enterprise and relied primarily on the fact that there was a 100% change of ownership between the loss years and the profit years. However, a *single* corporation was involved. The *Libson Shops* holding did not literally cover this case. The taxpayer petitioned this court for a writ of certiorari but it was denied. See also *Virgnia Metal Products Company* v. *Commissioner*, 33 T.C. 788, aff'd 290 F. 2d 675 (3rd Cir. 1961), cert. denied 368 U.S. 889 (1961) and *Norden-Ketay Corporation* v. *Commissioner*, 319 F. 2d 902 (2d Cir. 1963), cert. denied 375 U.S. 953 (1964).

The refusal of this Court to give guidance to the lower courts in the application, limitation or extension of the *Libson Shops* doctrine to situations not precisely covered by *Libson Shops* has resulted in a current flood of cases under the provisions of the Internal Revenue Code of 1939 and, surprisingly enough, prom-

ises the same effect under the provisions of the Internal Revenue Code of 1954.[3] There are pending in the courts a number of cases involving issues presented in the present case. In *Federal Cement Tile Company* v. *Commissioner*, 40 T.C. 1028, aff'd ... F. 2d ..., 64-2 U.S.T.C. ¶ 9863 (7th Cir. 1964), the Court of Appeals for the Seventh Circuit has applied the *Libson Shops* continuity of business enterprise doctrine to bar carryover of losses incurred in a cement tile business primarily conducted in the East against the same corporate entity's income from the same business in later years where primarily conducted in the middle West. In that case, an almost complete change of ownership took place as a result of a merger. In *Frederick Steel Company*, 42 T.C. 13 (1964), aff'd ... F. 2d ... (7th Cir. 1965), the Seventh Circuit refused to allow losses incurred in a beer and ice business to be offset against a later acquired steel business where there was a complete change of ownership and discontinuation of the beer and ice business. In *The Humacid Company*, 42 T.C. 894 (1964), the Tax Court applied the *Libson Shops* doctrine to bar carryover of losses by a single corporation incurred in the acid business against later profits from another business after the stock ownership changed as a result of a 25% shareholder buying out the other 75% ownership. In *Jeremiah J. O'Donnell, Jr.* v. *Commissioner*, T.C. Memo. 1964-38, 23

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[3] Cases which have applied the *Libson Shops* theory to the 1954 Code include *Arthur T. Beckett* v. *Commissioner*, 41 T.C. 386 (1963), appeal docketed in Ninth Circuit; *J. G. Dudley* v. *Commissioner*, 298 F. 2d 750 (4th Cir. 1962); *Huyler's* v. *Commissioner*, 327 F. 2d 767 (7th Cir. 1964); *Gulf Realty and Insurance Co.* v. *Tomlinson*, 63-1 U.S.T.C. ¶ 9174, 11 AFTR 2d 465 (M.D. Fla. 1962); *cf. Jackson Oldsmobile, Inc.* v. *United States*, 65-1 U.S.T.C. ¶ 9113 (M.D. Ga. 1964); *Calvin* v. *United States*, ... F. Supp. ...., 65-1 U.S.T.C. ¶ 9112 (D. Colo. 1964).

T.C.M. 210 (1964), the Tax Court refused under the *Libson Shops* doctrine to allow a single corporation to carry over losses incurred in the manufacture and sale of men's clothing against later profits incurred in the same location in the manufacture and sale of women's clothing where there was a complete change of ownership of the loss corporation. In the *O'Donnell* case, a family partnership purchased the stock of the loss corporation and then caused a profitable corporation to merge into the newly-acquired loss corporation. In *Fawick Corporation* v. *Commissioner*, T.C. Memo. 1964-65, 23 T.C.M. 194 (1964), aff'd ... F. 2d ... (6th Cir. 1965), again the Tax Court under the *Libson Shops* doctrine refused to allow a single, continuing corporation to carry over losses it had incurred in the brake manufacturing business against later profits generated in the motor bus business acquired by merger where majority control of the loss corporation was transferred to the shareholders of the profit corporation in the merger. See also *Foremost Dairies, Inc.* v. *Tomlinson*, ... F. Supp. ..., 63-2 U.S.T.C. ¶ 9648 (M.D. Fla. 1963), aff'd ... F. 2d ... (5th Cir. 1965).

Admittedly, each of these cases involved a complete change of business activity and a complete or almost complete change of stock ownership with the corporate entity as the only connecting link. It may be that the decisions of the lower courts are considered correct on the facts even though there was a continuing single corporation, but the failure of this Court to finally resolve this issue has left it hanging in the air for eight years.

A more difficult case arises where there is little or no change of ownership of a single corporation which changes its business as in *Northway Security Company*

or where a single corporation's business is not changed but its ownership is changed between the loss and profit years. In *Kolker Brothers, Inc.* v. *Commissioner,* 35 T.C. 299 (1960), Government's appeal dismissed (4th Cir. 1961), the Tax Court of the United States had before it a case of a loss corporation acquiring a new business by, in effect, issuance of 46% of its common stock. A single corporate entity was involved. The Court found that the new hotel supply business was not substantially different from the restaurant supply business in which the losses had been incurred. The change of ownership saw the shareholders who owned 100% of the stock of the corporation during the period of losses reduced to 54% of the stock of the corporation during the period of profits with the enhanced business. In view of these facts, the Tax Court held that the *Libsons Shops* doctrine did not bar carryover of the corporation's losses against its later profits. The Commissioner did not follow through its appeal in this case but has since refused to acquiesce in the result. Non-acquiescense noted, 1963-2 Cum. Bull. 6. Since there was no appeal, this Court had no opportunity to deal with the *Kolker Brothers* situation where there was only a change of minority ownership and an addition of related business of the same type previously carried on.

This Court did have the opportunity in the past few months to deal with a case involving a single corporation whose ownership changed as a result of merger of a related corporation where the common owner's percentage of ownership increased from 58% to 95%. *Julius Garfinckel & Co., Inc.* v. *Commissioner,* 335 F. 2d 744 (2d Cir. 1964), cert. denied, ..., U.S. ... (1965). The principal shareholder of the continuing

loss corporation in that case owned 58% of the stock at the time of the losses and 95% of the stock at the time of the profits. The Court of Appeals for the Second Circuit noted with regret the obvious justice of allowing the losses where the principal owner in effect suffered 58% of the losses and sought to recoup them against 95% of the later profits. Unfortunately, by denying certiorari, this Court lost the opportunity to give guidance on the issues of the effect of continuation of the loss corporation, the effect of the substantially similar but enhanced business after the merger, or the effect of the change of ownership affecting only a minority interest.

The *Garfinckel* case differs slightly from the *Kolker Brothers* case because in *Kolker Brothers* the shareholders who suffered 100% of the losses were allowed to recoup 54% of the losses by allowing carryover of the losses against later income. In *Garfinckel,* the shareholder who stood only 58% of the losses was attempting to derive benefit to the extent of 95%.

In each of these cases, a single continuing corporation is involved. The Supreme Court has never authoritatively stated whether the continuity of business enterprise theory applies at all to such situations. As noted, footnote 9 of the opinion in *Libson Shops* reserves this question. This question is presented in petitioner's case. Even if the *Libson Shops* doctrine does apply to a single continuing corporation, the Supreme Court has never authoritatively stated what constitutes continuation of the business enterprise, i.e., whether continuation of the same business, but enhanced by addition of a similar operation, qualifies under the 1939 Code as it presumably does under section 382(a) of the 1954 Code. This case involves that

question. Again, if the *Libson Shops* doctrine applies to a single continuing corporate entity, the Supreme Court has never authoritatively stated whether the fact that there is no change of ownership makes a difference. Petitioner submits that this fact does make a difference and this case presents the Court an opportunity to say so.

2. The decision below directly conflicts with the decision in Jackson Oldsmobile, Inc. v. United States.

In *Jackson Oldsmobile, Inc.* v. *United States, supra,* the District Court for the Middle District of Georgia decided that a corporation which liquidated its assets, then remained relatively inactive for a period of time and later recapitalized, changed its name and relocated, could carry over net operating losses and deduct them from profits earned after the recapitalization where there was a continuity of majority stock ownership, the legal entity of the taxpayer was unchanged, and the taxpayer corporation continued essentially the same business though in another location. In that case, the corporation, all of the voting stock of which was owned by General Motors and all of the non-voting stock by the "dealer", was in the business of operating a Buick dealership in Lamar, Colorado. The corporation sustained losses in 1953 and 1954. The corporation then began liquidation proceedings leaving the corporation basically a shell with ownership in General Motors Corporation. Later, a new dealership was organized in Macon, Georgia. The new dealer was allowed to purchase the non-voting stock of the shell corporation. General Motors continued as owner of all of the voting stock, which accounted for approximately 60% of the outstanding stock of the corporation. General Motors granted an Oldsmobile franchise to the

corporation. After creation of the new dealership, the corporation operated at a profit and sought to offset its Buick dealership losses against its Oldsmobile dealership profits. The Court distinguished the earlier single corporation cases where the *Libson Shops* doctrine had been applied on the ground that in each of these earlier cases, a new and entirely different business was carried on after a complete or almost complete change of ownership. The Court then found that operation of the Oldsmobile dealership was substantially similar to operation of the Buick dealership and that majority ownership continued in General Motors so that it, in effect, suffered the losses before and enjoyed the income after the changes.

The *Jackson Oldsmobile, Inc.* decision represents a direct conflict with the decision of the Court of Appeals for the Second Circuit in petitioner's case. In petitioner's case, there is the single, continuing corporate entity. There is complete ownership before and after the changes. There is continuation of the previous business enhanced by addition of substantially similar business operations, albeit in additional locations. The only difference, and this is a distinction without a difference, is that the principal asset in *Jackson Oldsmobile,* the Oldsmobile franchise, was contributed by the parent, General Motors Corporation, to the subsidiary, whereas in petitioner's case the additional assets were transferred to petitioner by way of merger of a wholly-owned subsidiary into petitioner. This is a distinction without a difference because it should make little difference how the parent places additional assets in the subsidiary assuming that valid business purpose for doing so exist. In this connection, Allied Stores Corporation could have liquidated the profit subsidiary tax

free under section 112(b)(6) of the Internal Revenue Code of 1939 and later contributed the assets to the loss subsidiary. Or, Allied Stores Corporation could have contributed the stock of the profit subsidiary to petitioner and petitioner could have then liquidated the profit subsidiary and there would be no question but that in either event petitioner would be entitled to carry over its previous losses against its later profits.

One further point of conflict between *Jackson Oldsmobile, Inc.* and petitioner's case is that no point whatsoever was made by the District Court that General Motors Corporation's stock was actively traded on the New York Stock Exchange. The Court obviously considered General Motors Corporation itself as the shareholder of its subsidiary's stock for purposes of determining whether the continuing owner economically suffered the losses as well as enjoyed the later income. In petitioner's case, the Court of Appeals for the Second Circuit, somewhat as an afterthought, pointed out that the possibility exists that the individual shareholders who could be said to have sustained the burden of the earlier losses might not be the same stockholders during the period of later income. It might be pointed out that there is no evidence in the record whether there were any sales of Allied Stores Corporation stock during the periods in question. The stipulated fact states only that the stock was listed on the New York Stock Exchange. It might also be added that majority control of Allied Stores Corporation probably was not traded in any event because the great bulk of its stock is and has been for a number of years in the hands of institutional investors.

3. The decision below conflicts in principle with the statutory structure under the Internal Revenue Code of 1954 which is applicable to petitioner's loss for its fiscal year ended January 31, 1954.

The decision below in petitioner's case when coupled with the possibility that the *Libson Shops* doctrine carries over under the 1954 Code would make a mockery of sections 381 and 382 of the 1954 Code. Section 381, *inter alia,* provides that net operating loss carryovers under section 172 are taken into account by the acquiring corporation in a transfer to which section 361 applies including mergers and C, D and F reorganization. If the *Libson Shops* doctrine operates as a limitation on section 172 as it does on section 122 of the Internal Revenue Code of 1939, and the cases listed in footnote 3, *supra*, p. 13 indicate that it does, there will be no net operating loss carryovers to take into account under section 381(a). The same would be true of section 382(a). This section is designed to bar use of net operating loss carryovers by a single continuing corporation whose stock ownership substantially changes within a relatively short period of time by a sale when coupled with a change in trade or business. In *Jackson Oldsmobile,* section 382(a) would have allowed carryovers, but if, again, *Libson Shops* bars the carryovers in the first place, there is nothing on which section 382(a) can operate. The same is true of section 382(b). If in a merger the transferor corporation or the acquiring corporation has a net operating loss carryover and the stockholders of the loss corporation own less than 20% of the fair market value of the outstanding stock of the acquiring corporation, the net operating loss carryover is cut back by 5 percentage points for each percentage point less than 20% owned by the former shareholders of the loss corporation.

But if there are no loss carryovers as a result of the *Libson Shops* doctrine, section 382(b) is an exercise in futility. Section 382(b)(3) provides that the limitation does not apply at all if the transferor and the acquiring corporation are owned substantially by the same presons in the same proportion. Quite obviously, Congress had in mind no cutback of net operating losses where the corporations were owned by the same persons in the same proportion, as is the case with Allied Stores Corporation, and its wholly-owned subsidiaries which were merged in petitioner's case.

The Commissioner has in part recognized the absurdity of attempting to apply the *Libson Shops* doctrine in cases to which section 381(a) applies. Rev. Rul. 58-383, 1958-2 Cum. Bull. 149; Rev. Rul. 59-395, 1959-2 Cum. Bull. 472. He has gone further and specified that a single, continuing corporation can acquire by purchase from outsiders a new business and can thereupon discontinue the old business without disallowance of its loss carryovers where there is no change of ownership. This applies apparently to the years governed by the Internal Revenue Code of 1939 as well as those governed by the Internal Revenue Code of 1954. Rev. Rul. 63-40, 1963-1 Cum. Bull. 46. Even the Commissioner has thus indicated that where there is no change of ownership, a corporation should be entitled to acquire a new business by use of its own resources or by use of those contributed to it by its parent. As a matter of fact, in the companion case which was filed by another subsidiary of Allied Stores Corporation, *D. M. Read, Inc.* v. *Commissioner*, Docket No. 1535-62, the Commissioner stipulated entry of judgment of no deficiency for the taxpayer's fiscal year ended January 31, 1954 where Allied Stores Corporation purchased a new profitable business in 1953

from an outsider and then contributed the assets to its loss subsidiary. Obviously, there was no change of ownership. Apparently in relying on Rev. Rul. 63-40, *supra*, the Commissioner agreed that a contribution of a new business to a wholly-owned subsidiary does not result in disallowance of carryovers under section 122 of the Internal Revenue Code of 1939. It seems odd that the Commissioner would continue to litigate the case where a parent corporation has simply contributed a profitable subsidiary's assets to a loss subsidiary by way of merger as in petitioner's case. Admittedly, there were business reasons for the merger in the present case. The point is that reshuffling of wholly-owned subsidiaries by merger, or capital contribution, motivated by important business considerations, should not bar use of carryovers under by the *Libson Shops* doctrine, as they are not barred under section 382 of the Internal Revenue Code of 1954.

The provisions of the Internal Revenue Code of 1954 would allow carryovers to a single corporate entity, even though complete ownership of stock changes so long as the business does not change. Section 382(a). It would allow a complete change of business so long as there is no change of ownership. It makes no distinction between acquisition of assets by way of merger or other reorganization or liquidation. But, these provisions assume that there are net operating loss carryovers available. If the *Libson Shops* doctrine applies, in many instances there would be no net operating loss carryovers on which these provisions could apply. While the Commissioner has said that he would not apply the *Libson Shops* doctrine in mergers under the 1954 Code, is this because of administrative fiat, because Congress has changed the law, or because the *Libson Shops* doctrine did not apply under the circumstances of petitioner's case even under the 1939 Code?

The second issue presented in this petition explores the applicability of the *Libson Shops* doctrine to a 1954 Code year. The key question is whether or not the provisions of the Internal Revenue Code of 1954 apply with respect to a merger which took place on October 31, 1953 where the taxpayer's fiscal year straddles January 1, 1954. Petitioner's position is that the provisions of section 172 covering the straddled situation make it clear that petitioner's net operating loss for the fiscal year ended January 31, 1954 is carried over in accordance with the provisions of the Internal Revenue Code of 1954. Because of the inconsistency between the *Libson Shops* doctrine and the statutory scheme under the 1954 Code, petitioner's position is that the *Libson Shops* doctrine does not apply under the Internal Revenue Code of 1954.

This position rests on the applicability of sections 381 and 382 to petitioner's situation. Neither the Tax Court of the United States nor the Court of Appeals for the Second Circuit in the proceedings below noted that sections 381 and 382 can apply to mergers taking place prior to June 22, 1954. The effective date provisions in sections 393 and 394 of the Internal Revenue Code of 1954 quoted in pertinent part in Appendix B, *infra,* make it clear that there are exceptions to the June 22, 1954 date. Section 172 operates with respect to straddle-year taxpayers, such as petitioner. Section 381(c) is dependent on section 172. Consequently, the effective date of the reorganization provisions under section 393(a) and the effective date of sections 381 and 382 are dependent on the effective date of section 172. This is an exception and appears in subchapter C. Consequently, the Internal Revenue Code of 1954, including sections 172, 381 and 382, applies to the net operating loss for the fiscal year ended January 31, 1954 and the Court is then faced with the issue

whether the *Libson Shops* doctrine applies to mergers governed by provisions of the Internal Revenue Code of 1954. This alternative position, of course, need not be reached if petitioner's principal position is sustained.

In summary, the grounds upon which petitioner relies in this petition for a writ of certiorari are:

1. The decision of the Court of Appeals for the Second Circuit in this case erroneously decides a question of continuing importance both under the Internal Revenue Code of 1939 and under the Internal Revenue Code of 1954.

2. The decision is in direct conflict with the recent decision of the District Court for the Middle District of Georgia in the case of *Jackson Oldsmobile, Inc.* v. *United States, supra.*

3. If correct, the decision makes a mockery of sections 381 and 382 of the Internal Revenue Code of 1954.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 98—September Term, 1964.

(Argued October 28, 1964 Decided December 17, 1964.)

Docket No. 29029

ALLIED CENTRAL STORES, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Before: LUMBARD, *Chief Judge*, HAYS and MARSHALL, *Circuit Judges*.

Petition for review of a decision of the Tax Court, Withey, *Judge*, T. C. Memo. 1964-45, CCH Tax Ct. Mem. Dec. 26668(m), denying the deduction of a pre-merger net operating loss carryover from post-merger profits.

Affirmed.

PERCY W. PHILLIPS, Washington, D. C. (Ivins, Phillips & Barker, of counsel), *for Petitioner*.

NORMAN H. WOLFE, Attorney, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson and Gilbert E. Andrews, Attorneys, Department of Justice, of counsel), *for Respondent*.

HAYS, Circuit Judge:

Petitioner owns and operates a department store in Kansas City, Missouri. In 1953 Heer's, Inc., which owned a department store in Springfield, Missouri, was merged into petitioner and in 1956 two other corporations, L. S. Donaldson Company and The Golden Rule, which together owned five department stores in Minnesota and South Dakota, were merged into petitioner.

Petitioner sought to carry over net operating losses for its fiscal years ending January 31, 1951, 1952 and 1954 as deductions from its taxable income for the fiscal years ending in 1955 and 1957.

Under the authority of *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382 (1957), the respondent determined that petitioner was not entitled to carry over pre-merger net operating losses as deductions from post-merger income and asserted a deficiency of $155,508.38 for the fiscal year ending January 31, 1957. On petition, the Tax Court held that Section 172 of the Internal Revenue Code of 1954 made the predecessor sections of the 1939 Code, under which *Libson Shops* was decided, applicable to determine whether or not a net operating loss from petitioner's taxable years ending January 31, 1951, 1952 and 1954 could be deducted from 1955 and 1957 income; that the 1939 Code and *Libson Shops* precluded the deduction of carry-overs of pre-merger losses against post-merger income unless the taxpayer could show that the income was produced by substantially the same business unit, i.e., the Kansas City store, that produced the losses; and that petitioner had not made such proof. Therefore, the Tax Court denied the deductions claimed.

We affirm the decision of the Tax Court. We see no distinction between this case and *Libson Shops*. See also our recent decision in *Julius Garfinckel & Co.* v. *Commissioner*, 335 F. 2d 744 (2d Cir. 1964).

Petitioner argues that *Libson Shops* is distinguishable because here there was and could be no change of ownership of any of the merging corporations, all being wholly owned and controlled by a parent corporation during this period, and because there was no change of business enterprise, since the economy identity of the stores as a small group of the parent corporation's nationwide chain of similar stores remained the same before and after the corporate mergers.

But in *Libson Shops* there was likewise no change in ownership. Actually in the present case the ultimate ownership, as reflected in the ownership of the shares of the parent corporation which are traded on the New York Stock Exchange, may well not have been in 1957 in the hands of those who had suffered the losses in 1951, 1952 and 1954.

The parent corporation has chosen to treat the petitioner as a separate entity filing a separate return, rather than as part of a single enterprise filing a consolidated return. As a separate entity the petitioner was not the same "business enterprise" in 1957 that it was prior to the mergers. The regrouping of subsidiaries which have been treated as separate entities, with resultant changes in stated capital, total assets and net worth, has an effect on "continuity."

Petitioner argues that, regardless of the result reached with respect to 1951 and 1952, the Internal Revenue Code of 1954 must be applied to determine the deductibility of net operating losses with respect to loss years ending after December 31, 1953 and therefore to petitioner's fiscal year ending January 31, 1954, and that *Libson Shops* is not applicable under the 1954 Code.

If *Libson Shops* was superseded by the 1954 Code the superseding sections are Sections 381 and 382. However, these sections are applicable only to mergers occurring after June 22, 1954. See Int. Rev. Code of 1954, §§ 393-94. The merger of Heer's into petitioner occurred on October 31, 1953. In order to avoid the application of *Libson Shops* under the 1939 Code, petitioner must argue that a pre-June 22, 1954 merger which occurred in a fiscal year ending after December 31, 1953, is governed by a rule independent of and different from both *Libson Shops* and the special rules of the 1954 Code, i.e., that the congressional purpose in deferring the effect of Sections 381-82 to June 22, 1954, was to abrogate 1939 Code case law for a short time before sub-

stituting the explicit rules of Sections 381-82. But June 22, 1954, was chosen as a convenient date, shortly before which the congressional committees had announced the new rules, from which corporate taxpayers, who planned mergers, etc., would be put on notice of certain tax consequences.[1] We conclude, therefore, that until June 22, 1954, *Libson Shops* remained applicable even to fiscal years ending after December 31, 1953, for the purpose of determining deductibility of net operating losses.

Section 7851(a)(1)(C) of the Internal Revenue Code specifically provides that:

> "The provisions of the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title [i.e., the income tax provisions] the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A."

From this section it appears, as the Tax Court held, that those provisions of the 1939 Code which were construed in *Libson Shops* are deemed included in the 1954 Code, but apply only to the period before June 22, 1954, when the specific provisions of Sections 381 and 382 became applicable to mergers.

Affirmed.

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[1] See H. R. Rep. No. 1337, 83d Cong., 2d Sess. A145 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 287-88 (1954); H. R. Rep. No. 2543 (Conference Comm. Report), 83d Cong., 2d Sess. 40-41 (1954); all of which are reprinted in [1954] 3 U. S. Code Cong. Ad. News at 4283-84, 4926-27, 5300.

APPENDIX B

Statutes Involved

Internal Revenue Code of 1939:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

"SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

(1) Net operating loss carry-back.—

* * * * *

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

(2) Net operating loss carry-over.—

* * * * *

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years,

* * * * *

(c) *Amount of Net operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction, or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(h) and (i)).

Internal Revenue Code of 1954:

"SEC. 172. (a) *Deduction allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

(b) *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to Which Loss May Be Carried.*—A net operating loss for any taxable year ending after December 31, 1953, shall be—

(A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(e) *Law Applicable to Computations.*—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the

law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

* * * * *

(g) *Special Transitional Rules.*—

(1) *Losses For Taxable Years Ending Before January 1, 1954.*—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939."

"SEC. 381. *Carryovers in Certain Corporate Acquisitions*

(a) *General rule.*—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) *Operating rules.*—Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) *Items of the distributor or transferor corporation.*—The items referred to in subsection (a) are:

(1) *Net operating loss carryovers.*—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) In determining the net operating loss deduction, the portion of such deduction attributable to

the net operating loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For the purpose of determining the amount of the net operating loss carryovers under section 172(b)(2), a net operating loss for a taxable year (hereinafter in this subparagraph referred to as the "loss year") of a distributor or transferor corporation which ends on or before the end of a loss year of the acquiring corporation shall be considered to be a net operating loss for a year prior to such loss year of the acquiring corporation. For the same purpose, the taxable income for a "prior taxable year" (as the term is used in section 172(b)(2)) shall be computed as provided in such section; except that, if the date of distribution or transfer is on a day other than the last day of a taxable year of the acquiring corporation—

(i) such taxable year shall (for the purpose of this subparagraph only) be considered to be 2 taxable years (hereinafter in this subparagraph referred to as the "pre-acquisition part year" and the "post-acquisition part year");

(ii) the pre-acquisition part year shall begin on the same day as such taxable year begins and shall end on the date of distribution or transfer;

(iii) the post-acquisition part year shall begin on the day following the date of distribution or

transfer and shall end on the same day as the end of such taxable year;

(iv) the taxable income for such taxable year (computed with the modifications specified in section 172(b)(2)(A) but without a net operating loss deduction) shall be divided between the pre-acquisition part year and the post-acquisition part year in proportion to the number of days in each;

(v) the net operating loss deduction for the pre-acquisition part year shall be determined as provided in section 172(b)(2)(B), but without regard to a net operating loss year of the distributor or transferor corporation; and

(vi) the net operating loss deduction for the post-acquisition part year shall be determined as provided in section 172(b)(2)(B)."

* * * * *

"SEC. 382. *Special limitations on net operating loss carryovers*

(a) *Purchase of a corporation and change in its trade or business.*—

(1) *In general.*—If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

(2) *Description of person or persons.*—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less)

who own the greatest percentage of the fair market value of such outstanding stock.

(3) *Attribution of ownership.*—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that section 318(a)(2)(C) shall be applied without regard to the 50 percent limitation contained therein.

(4) *Definition of purchase.*—For purposes of this subsection, the term "purchase" means the acquisition of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

(b) *Change of ownership as the result of a reorganization.*—

(1) *In general.*—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable

year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) *Reduction of net operating loss carryover.*—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

(3) *Exception to limitation in this subsection.*—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) *Net operating loss carryovers to subsequent years.*—In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172(b)(2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) *Attribution of ownership.*—If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of

the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned by such transferor corporation or acquiring corporation as the fair market value of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6). *Stock of corporation controlling acquiring corporation.*—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

(c) *Definition of stock.*—For purposes of this section, "stock" means all shares except nonvoting stock which is limited and preferred as to dividends."

PART VI—EFFECTIVE DATE OF SUBCHAPTER C

* * * * *

"SEC. 393. *Effective dates of parts III and IV*

(a) *General rule.*—Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954."

* * * * *

"SEC. 394. *Effective date of part V*

(a) *Section 381.*—Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and re-

organizations, the tax treatment of which is determined under this Code.

(b) *Section 382(a).*—For purposes of applying the special limitation on net operating loss carryovers in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) *Section 382(b).*—Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code."

"SEC. 395. *Special rules for application of this subchapter*

(a) *Taxable years affected.*—Any provision of this subchapter the applicability of which is stated in terms of a specific date shall apply with respect to taxable years ending after such date. Each provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall apply only to taxable years ending after such specific date.

(b) *Repeal and continuance of International Revenue Code of 1939.*—To the extent that the provisions of this subchapter supersede the provisions of the Internal Revenue Code of 1939, such provisions of the Internal Revenue Code of 1939 are hereby repealed. The provisions of the Internal Revenue Code of 1939 shall continue to apply with respect to transactions for which rules are provided in this subchapter until such rules take effect."

SUBCHAPTER B—EFFECTIVE DATE AND RELATED PROVISIONS

Sec.
7851. Applicability of revenue laws.

• • • • •

"SEC. 7851. *Applicablity of revenue laws*

(a) *General rules.*—Except as otherwise provided in any section of this title —

(1) *Subtitle A.*—

(A) Chapters 1, 2, 4, and 6 of this title shall apply only with respect to taxable years beginning after December 31, 1953, and ending after the date of enactment of this title, and with respect to such taxable years, chapters 1 (except sections 143 and 144) and 2, and section 3801, of the Internal Revenue Code of 1939 are hereby repealed.

(B) Chapters 3 and 5 of this title shall apply with respect to payments and transfers occurring after December 31, 1954, and as to such payments and transfers sections 143 and 144 and chapter 7 of the Internal Revenue Code of 1939 are hereby repealed.

(C) Any provision of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953), or in terms of taxable years ending after a specific date (occurring after December 31, 1953), shall apply to taxable years ending after such specific date. Each such provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall be applicable only to taxable years ending after such specific date. The provisions of

the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A."

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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 988

ALLIED CENTRAL STORES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 18–42) are not officially reported. The opinion of the court of appeals (Pet. 1a–4a) is reported at 339 F. 2d 503.[1]

JURISDICTION

The judgment of the court of appeals was entered on December 17, 1964. The petition for a writ of certiorari was filed on March 15, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, net operating losses sustained by petitioner

[1] "Pet." references are to the petition for a writ of certiorari, and "R." references are to the separately bound Appendix A to petitioner's brief in the court of appeals.

before its merger with three other corporations could be carried forward to offset the income earned in post-merger years by the merged corporations.

STATUTES INVOLVED

The pertinent portions of Sections 23 and 122 of the Internal Revenue Code of 1939 and Sections 172, 381, 382, 393, 394 and 7851 of the Internal Revenue Code of 1954 are set forth in the Appendix, pp. 9–16, *infra*.

STATEMENT

Prior to 1953, petitioner, a wholly-owned subsidiary of Allied Stores Corporation, was the owner-operator of a single department store in Kansas City, Missouri. In 1953, Heer's, Inc., which owned a department store in Springfield, Missouri, and was also a wholly-owned subsidiary of Allied Stores, was merged into petitioner. In 1956, two other corporate subsidiaries of Allied Stores—L. S. Donaldson Company and The Golden Rule—which together owned five department stores in Minnesota and South Dakota, also were merged into petitioner (Pet. 1a; R. 19–20).

Petitioner reported net operating losses on its federal income tax returns for the taxable years ending January 31, 1951, 1952 and 1954. It claimed the right to carry forward these losses to offset income which had been realized from the operations of the corporation after the merger. Respondent disallowed the loss carryovers. Both the Tax Court and the court of appeals held that the "continuity of business enterprise" test enunciated in *Libson Shops, Inc.* v. *Koeh-*

ler, 353 U.S. 382, precluded the offset of petitioner's post-merger income by pre-merger losses (Pet. 2a; R. 22–23). Petitioner argued alternatively that the *Libson Shops* rule did not apply to the loss year ending January 31, 1954, for the asserted reason that Section 382(b) of the 1954 Code was the exclusive limitation on loss carryovers from and after 1954. The court held that the application of Section 382(b) was expressly limited to mergers occurring after June 22, 1954, so that the provision had no bearing on the question whether pre-merger losses could be offset against petitioner's gains after the 1953 merger of Heer's, Inc., into petitioner (Pet. 3a–4a).

ARGUMENT

1. *In Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, sixteen corporations operating retail stores selling women's apparel were merged into a seventeenth corporation which had been providing management services for the sale corporations. All of the corporations were owned by the same individuals, whose proportionate ownership interests were the same before and after the merger. Three of the sales constituents incurred operating losses before and after the merger. The surviving corporation attempted to carry forward the pre-merger losses to offset income of the post-merger consolidated enterprise. Holding that the surviving corporation was not the same "taxpayer" as its pre-merger constituents within the meaning of Section 122(b) of the 1939 Code (pp. 9–10, *infra*), and observing that the purpose of the carryover provisions was not to give a merged taxpayer

advantages over others who did not merge, this Court concluded that (353 U.S. at 390) "petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same business which incurred the losses."

The present case comes squarely within the *Libson Shops* principle. Petitioner was originally the owner-operator of a single unprofitable store in Kansas City, Missouri. Its parent corporation then attempted to carry forward, through successive mergers with other subsidiaries conducting similar operations, petitioner's net operating losses incurred in pre-merger taxable years. Following these mergers, petitioner was the owner-operator of a chain of seven stores located in various cities in Missouri, Minnesota, and South Dakota, but petitioner could make no showing that the same business (*i.e.*, the Kansas City store) which had suffered the net operating losses also produced the income against which petitioner sought to offset these losses. In effect, petitioner's parent corporation sought to accomplish the very same result by merging three other corporations into petitioner that the shareholders in *Libson Shops* tried to achieve by merging its 17 corporations.

Petitioner contends that this case is distinguishable from *Libson Shops* for three reasons: (1) *Libson Shops* does not apply where the corporation seeking the benefit of the carryover is the same legal entity which sustained the losses; (2) there is no clear and workable standard for determining whether the business activity which sustained the losses is the same business producing the income to be offset by such

losses; and (3) *Libson Shops* does not apply where there has been no change in stock ownership (Pet. 7–17). None of these arguments has merit.

a. The courts of appeals which have applied *Libson Shops* have unanimously held that it makes no difference in the application of the principle whether or not it is the loss corporation which technically survives the merger. *Julius Garfinckel & Co.* v. *Commissioner*, 335 F. 2d 744 (C.A. 2), certiorari denied, 379 U.S. 962; *Norden-Ketay Corp.* v. *Commissioner*, 319 F. 2d 902 (C.A. 2), certiorari denied, 375 U.S. 953; *Mill Ridge Coal Co.* v. *Patterson*, 264 F. 2d 713 (C.A. 5), certiorari denied, 361 U.S. 816; *Commissioner* v. *Virginia Metal Products, Inc.*, 290 F. 2d 675 (C.A. 3), certiorari denied, 368 U.S. 889; *Willingham* v. *United States*, 289 F. 2d 283 (C.A. 5), certiorari denied, 368 U.S. 828; *J. G. Dudley Co.* v. *Commissioner*, 298 F. 2d 750 (C.A. 4); *Hwyler's* v. *Commissioner*, 327 F. 2d 767 (C.A. 7); *Federal Cement Tile Co.* v. *Commissioner*, 338 F. 2d 691 (C.A. 7); *Foremost Dairies, Inc.* v. *Tomlinson* (C.A. 5), decided February 11, 1965, 15 A.F.T.R. 2d 362; *Fawick Corp.* v. *Commissioner* (C.A. 6), decided March 25, 1965, 15 A.F.T.R. 2d 617. It would obviously serve no intelligible legislative purpose to have the availability of the tax benefit hinge upon whether the merged entity bears the name and charter of the loss corporation or of one of the other merging bodies.

b. *Libson Shops* established that a ladies' ready-to-wear shop in one location is not substantially the same business as another ladies' ready-to-wear shop with different assets at a different location. It follows from that decision that the single Kansas City department

store owned and operated by petitioner prior to the 1953 merger was not the same business as the other department stores in other locations which were merged into it.[2]

c. There was no greater change in stock ownership in *Libson Shops* than in the present case; in both instances stockholders owned the resulting corporation in exactly the same proportion that they had previously owned the constituent corporations involved in the merger. The fact that Allied Stores owned all of petitioner's stock as well as the stock of the merged corporations only supports the observation in *Libson Shops* (353 U.S. at 388): "If petitioner is permitted to take a carry-over * * * businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return."

2. Petitioner also asserts (Pet. 17–19) that a conflict exists between this case and the district court decision in *Jackson Oldsmobile, Inc.*, v. *United States*, decided November 13, 1964, 15 A.F.T.R. 2d 035 (M.D. Ga. 1964), on appeal to C.A. 5. The *Jackson Oldsmobile* decision does conflict in principle with the present case, but it is being appealed to the Fifth Circuit.

---

[2] Petitioner contends that the present case presents the issue reserved in footnote 9 of the *Libson Shops* opinion. 353 U.S. at 390, n. 9 (Pet. 10–12). But that footnote was obviously not referring to a situation in which the business of one wholly-owned subsidiary is taken over by another wholly-owned subsidiary of the same parent. When the new business is nothing more than a wholly-owned subsidiary of the same parent, the merger amounts to an attempt by the parent to set off one operation's loss against the subsequent taxable income of another—precisely what the shareholders sought to do in *Libson Shops*.

Since that court recently cited the present decision with approval in *Foremost Dairies, Inc.* v. *Tomlinson*, decided February 11, 1965, 15 A.F.T.R. 2d 362, there is reason to believe that the court of appeals will reverse the *Jackson Oldsmobile* decision. In any event, a conflict between a court of appeals decision and a district court decision in another circuit is not an adequate basis for review by this Court.

3. Petitioner's argument (Pet. 20–24) that the *Libson Shops* principle does not apply to losses incurred in its taxable year ended January 31, 1954, because of Sections 381 and 382 of the 1954 Code, is equally without substance. Sections 393(a) and 394 (a) and (c) of the 1954 Code (pp. 15–16, *infra*), establish that neither Section 381(a) nor Section 382(b) applies to mergers taking place prior to June 22, 1954.[3] The merger of Heer's into petitioner occurred on October 31, 1953, which was before the applicable date, and petitioner made no attempt to segregate the profits of Heer's and those of the corporations which were merged into petitioner after 1954.

---

[3] Taxpayer erroneously contends (Pet. 23) that the reference to Section 172 in Section 381(c) means that the effective date of Sections 381 and 382 depends upon the effective date of Section 172. The cross reference in Section 381(c) merely requires that for purposes of Section 381(a) the net operating loss carryovers shall be computed under Section 172, subject to specified conditions and limitations. But this computation applies only after the effective date of Section 381, which is specified in Sections 393(a) and 394(a).

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CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL 1965.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [as added by Sec. 211(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(26 U.S.C., 1952 ed., 23.)

* * * * *

SEC. 122 [as added by Sec. 211(b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [as amended by Sec. 105(e)(3)(A) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Sec. 215(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

* * * * *

(2) *Net operating loss carry-over.*—

* * * * *

(B) *Loss for taxable year beginning after 1949.*—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the

carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

* * * * *

(c) [as amended by Sec. 105(e)(3)(B) and Sec. 153(b) of the Revenue Act of 1942, *supra*, and Sec. 121(c)(2) of the Revenue Act of 1950, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds in the case of a taxpayer other than a corporation, the net income

computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credits provided in section 26 (h) and (i)).

* * * * *

(26 U.S.C., 1952 ed., 122.)

Internal Revenue Code of 1954:

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to which loss may be carried.*—A net operating loss for any taxable year ending after December 31, 1953, shall be—

(A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(c) *Net Operating Loss Defined.*—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

* * * * *

(e) *Law Applicable to Computations.*—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other

taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

* * * * *

(g) *Special Transitional Rules.*—

(1) *Losses for taxable years ending before January 1, 1954.*—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939.

* * * * *

(h) *Cross References.*—

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

(26 U.S.C. 172.)

* * * * *

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) *General Rule.*—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

* * * * *

(c) *Items of the Distributor or Transferor Corporation.*—The items referred to in subsection (a) are:

(1) *Net operating loss carryovers.*—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

* * * * *

(26 U.S.C. 381.)

SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS.

* * * * *

(b) *Change of Ownership as the Result of a Reorganization.*—

(1) *In General.*—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corpo-

ration ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) *Reduction of net operating loss carryover.*—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

(3) *Exception to limitation in this subsection.*—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) *Net operating loss carryovers to subsequent years.*—In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172(b)(2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) *Attribution of ownership.*—If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned

by such transferor corporation or acquiring corporation as the fair market value of the of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6) *Stock of corporation controlling acquiring corporation.*—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

* * * * *

(26 U.S.C. 382.)

PART VI—EFFECTIVE DATE OF SUBCHAPTER C

* * * * *

SEC. 393. EFFECTIVE DATES OF PARTS III AND IV.

(a) *General Rule.*—Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954.

* * * * *

(26 U.S.C. 393.)

SEC. 394. EFFECTIVE DATE OF PART V.

(a) *Section 381.*—Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and reorganizations, the tax treatment of which is determined under this Code.

(b) *Section 382(a).*—For purposes of applying the special limitation on net operating loss carryovers in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) *Section 382(b).*—Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code.

(26 U.S.C. 394.)

* * * * *

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) *General Rules.*—Except as otherwise provided in any section of this title—

(1) *Subtitle A.*—

* * * * *

(C) * * * The provisions of the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A.

* * * * *

(26 U.S.C. 7851.)

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OCTOBER TERM, 1964

ALLIED CENTRAL STORES, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

INTRODUCTION

Pursuant to Rule 24(4) of the Rules of the Supreme Court, Petitioner respectfully submits this reply brief to argue one point mentioned in respondent's brief in opposition.

ARGUMENT

On pages 6 and 7 of respondent's brief in opposition, respondent concedes that the decision in *Jackson Oldsmobile, Inc.* v. *United States,* 15 A.F.T.R. 2d 35, 65-1 U.S.T.C. ¶9113 (M.D. Ga. 1964) conflicts in principle with the decision of the Court of Appeals for the Second Circuit in the present case. Respondent, however, attempts to minimize the significance of the conflict by suggesting (1) that in view of its decision in *Foremost Dairies, Inc.* v. *Tomlinson,* 15 A.F.T.R. 2d 362 (5th Cir. 1965) the Court of Appeals for the Fifth Circuit will reverse the *Jackson Oldsmobile* decision, and (2) that a conflict between a court of appeals and a district court in another circuit is not a sufficient basis for review by this Court.

I

Anyone who has read the facts of the *Foremost Dairies, Inc.* case can hardly be of the opinion that it represents a foregone conclusion that the Court of Appeals for the Fifth Circuit will reverse the decision in *Jackson Oldsmobile, Inc.* See *Foremost Dairies, Inc.* v. *Tomlinson,* 12 A.F.T.R. 2d 5426 (N.D. Fla. 1964), aff'd 15 A.F.T.R. 2d 362 (5th Cir. 1965). In *Foremost Dairies, Inc.* v. *Tomlinson* a large, profitable general food distributor merged into a less frozen food distributor with the stockholders of the profitable corporation ending up with over 73% of the stock of the surviving corporation. The major changes in the items sold and the substantial change in ownership made the case similar to *Mill Ridge Coal Co.* v. *Patterson,* 264 F. 2d 713 (5th Cir. 1959), cert. den. 361 U.S. 816 (1959) and *Willingham* v. *United States,* 289 F. 2d 283 (5th Cir. 1961). Quite clearly these precedents in the Fifth

Circuit dictated the decision in the *Foremost Dairies, Inc.* case. The Court in its per curiam merely points out that the district court relied on the *Garfinckel* case in the Second Circuit. Without passing judgment one way or the other, the Court merely added a citation of *Allied Central Stores, Inc.* v. *Commissioner.*

The *Foremost Dairies* case gives little indication of what the Fifth Circuit will do with the *Jackson Oldsmobile* case. In the *Jackson Oldsmobile* case, there was a single owner of the corporation which discontinued a losing Buick dealership and entered a profitable Oldsmobile dealership business in a different state. These facts make it substantially similar to the decision in *Northway Security Company* v. *Commissioner,* 23 B.T.A. 532 (1931) which this Court mentioned in footnote 9 to the *Libson Shops* opinion. *Libson Shops, Inc.* v. *Koehler,* 352 U.S. 382, 390 (1957). The fact that the same owner, General Motors Corporation, suffered 100% of the losses and earned 100% of the later profits in *Jackson Oldsmobile, Inc.* gives a sound equitable, economic and legal basis to the taxpayer's position in that case, as it does in petitioner's case. If Congress intended any corporation to utilize the loss carryover provisions, it must have intended a corporation such as Northway Security Company, Jackson Oldsmobile, Inc. or, for that matter petitioner. Otherwise, denial of loss corryovers would be a serious economic deterrent to discontinuation of a losing activity in order to engage in a more profitable pursuant. See *Norden-Ketay Corporation* v. *Commissioner,* 319 F. 2d 902 (2d Cir. 1963), cert. den. 375 U.S. 953 (1964). Even the Tax Court of the United States, which has been rather harsh in net operating loss carryover situations, in *Kolker Brothers, Inc.* v. *Commissioner,* 35 T.C. 299 (1960) allowed

a single corporation whose business changed but whose ownership changed by only 46 percent to utilize its earlier losses against its later income. In that case, the Government's appeal was dismissed. There is no assurance that the Government will not withdraw its appeal in *Jackson Oldsmobile* and thus deprive the Supreme Court of a conflict at the court of appeals level as it did in the *Kolker Brothers, Inc.* case.

II

Respondent states that even though there is a conflict, a conflict between a court of appeals decision and a district court decision in another circuit is not an adequate basis for review by this Court. While Rule 19.1(b) of the Rules of the Supreme Court mentions that a conflict between a decision of a court of appeals with that of another court of appeals will be given consideration as a basis for review by the Supreme Court, surely this enumeration is not exclusive. There have been occasions when the Court has granted certiorari where there have been conflicts between a court of appeals and a district court in another circuit, especially where an important question of federal law has not been, but should be, settled by the Supreme Court. *Shapiro* v. *United States,* 335 U.S. 1, 4 (1948). It seems unjust to deny certiorari in petitioner's situation where a conflicting district court decision is pending on appeal to another court of appeals and where petitioner cannot delay his petition for certiorari until the other appeal has been decided. *Gulf States Steel Company* v. *United States,* 287 U.S. 32 (1932). It also seems unjust to petitioner that the Government has the opportunity to control whether a conflict develops at the court of appeal level by its power to dismiss its appeal

in the *Jackson Oldsmobile* case and to rely on its *in terrorem* administrative power as it did in *Kolker Brothers, Inc.* thus forcing continued expensive litigation in the lower courts.

CONCLUSION

There exists an acknowledged conflict in principle between the decision of the Court of Appeals for the Second Circuit in petitioner's case and the decision of the Middle District of Georgia in *Jackson Oldsmobile, Inc.* v. *United States.* Existence of this conflict indicates quite clearly that a fundamental difference of opinion exists as to the scope of this Court's *Libson Shops* decision. It is likely that the Court of Appeals for the Fifth Circuit will not consider its decision in the *Foremost Dairies* case as dispositive of the appeal in *Jackson Oldsmobile, Inc.* in view of the fact that there are basic factual differences. The *Foremost Dairies* case is illustrative of the evil with which the Court was apparently concerned in *Libson Shops,* trafficing in loss corporations. The *Jackson Oldsmobile* case involves a single owner of a corporation which changed the location of essentially the same business. Petitioner's case involves a single owner of a corporation which continued its earlier business as well as received additional, similar assets from its parent by way of merger of a sister corporation into it. These basic factual differences indicate that the *Foremost Dairies* case does not portend that the present conflict will disappear, as the respondent would have it. This Court has granted certiorari where a conflict between a court of appeals and a district court in another circuit has existed, especially where an important, unsettled question of federal law is involved as is the case here. This would seem especially appealing where a conflicting

district court decision is currently pending on appeal but where the petitioner cannot delay his petition for certiorari until the other appeal has been decided and it is within the control of the Government whether the appeal is prosecuted to decision and, if so, whether a petition for certiorari will be filed.

Respectfully submitted,

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No. 988

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

ALLIED CENTRAL STORES, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

Petitioner, Allied Central Stores, Inc., respectfully prays that this Court grant rehearing of its order of May 3, 1965 denying the petition for writ of certiorari and that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit in the above entitled case as prayed for in the petition filed on March 15, 1965.

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT

(1) At the time of this Court's order of May 3, 1965, there appeared to be no conflict of decisions at the court of appeals level on the questions sought to be reviewed. Since that time a direct and explicit conflict has appeared. On May 5, 1965, the Commerce Clearing House advanced sheets made the first publication of the decision of the U. S. Court of Appeals for the Ninth Circuit which reversed the Tax Court decision in *Arthur T. Beckett* v. *Commissioner,* 41 T.C. 386 (1963). The opinion of the Court of Appeals for the Ninth Circuit appears under the name *Maxwell Hardware Company* v. *Commissioner,* 65-1 U.S.T.C. ¶ 9332 (9th Cir. 1965). A copy of the opinion of the Court of Appeals is appended hereto.

In the *Maxwell Hardware Company* case, a corporation had incurred over $1,000,000 of operating losses during fiscal years ended January 31, 1951 through January 31, 1955. On October 18, 1954 two partners engaged in profitable real estate development activities entered into an agreement with Maxwell Hardware Company whereby a real estate department was established in the corporation to develop a subdivision, the funds therefor being furnished by the two partners through purchases of preferred stock in the corporation for an amount which was approximately two-fifths (2/5) of the then value of the common stock of Maxwell Hardware Company. The real estate department was operated independently of the other corporate business. The hardware business was discontinued. The corporation sought to offset its hardware losses of fiscal years 1951-1955 against the real estate development income for the years 1957-1960. The Tax Court

held that even though section 269 and section 382 of the Internal Revenue Code of 1954 were not applicable to the partial change of ownership and complete change of business on October 18, 1954, the Libson Shops doctrine barred use of the earlier hardware losses against the later real estate income. The Court of Appeals for the Ninth Circuit reversed the Tax Court and held that the 1951-1955 losses of the hardware business could be offset against the later income from the real estate business because the *Libson Shops* case does not apply under the 1954 Code.

In the *Maxwell Hardware Company* case, the taxpayer was attempting to carry over pre-1954 Code losses against post-1954 income. Section 172(g)(1) of the Internal Revenue Code of 1954 makes clear that the Internal Revenue Code of 1939 governs the years to which a pre-1954 net operating loss may be carried. The section under the Internal Revenue Code of 1939 which is involved is section 122. The *Libson Shops* doctrine has heretofore been thought by some, including the Internal Revenue Service, to be a broad and unrestricted construction of section 122. The Court of Appeals for the Ninth Circuit has now held that the *Libson Shops* interpretation of section 122 of the Internal Revenue Code of 1939 is restricted and in fact inapplicable where a single continuing corporation whose business changed completely but whose ownership changed only slightly is involved and where the year to which the loss is to be carried is a 1954 Code year.

This treatment of pre-1954 Code losses against post-1954 Code income from a different business is directly in conflict with the decision of the Court of Appeals for the Second Circuit in petitioner's case. It will be

recalled that petitioner seeks to offset net operating losses for its fiscal years ended January 31, 1951, 1952 and 1954 against its profits for 1955 and 1957.

(2) Not only is there a conflict now at the court of appeals level, but it appears that there is now more reason to believe that a conflict will materialize between the decision of the Court of Appeals for the Second Circuit in petitioner's case and the decision of the Court of Appeals for the Fifth Circuit in the appeal pending before that court from the district court decision in the case of *Jackson Oldsmobile, Inc.* v. *United States,* 237 F. Supp. 779 (M.D. Ga. 1964). As pointed out in our petition for certiorari, there are compelling arguments to support the decision of the District Court for the Middle District of Georgia. In view of the treatment of the *Libson Shops* doctrine by the Court of Appeals for the Ninth Circuit in the *Maxwell Hardware Company* case, it is now even more likely that the Court of Appeals for the Fifth Circuit will decide the *Jackson Oldsmobile, Inc.* case for the taxpayer. The Solicitor General has already acknowledged that the decision of the District Court for the Middle District of Georgia in the *Jackson Oldsmobile, Inc.* case is in direct conflict with the decision of the Court of Appeals for the Second Circuit in petitioner's case. The conflicts which are developing point to the importance and necessity for this Court to make an authoritative pronouncement on the scope of the *Libson Shops* doctrine.

CONCLUSION

It is now clear that a clarification of the application of the principle laid down by this Court in *Libson Shops* is badly needed. For the reasons set forth above and in the petition of writ of certiorari, it is respectfully urged that rehearing be granted and upon such rehearing a writ of certiorari issue to the Court of Appeals for the Second Circuit. If further conflict among the Courts of Appeals is thought necessary, at the very least it is respectfully urged that this Court's order denying petitioner's petition for writ of certiorari be withdrawn to await the outcome of the appeal in *Jackson Oldsmobile, Inc.*

Respectfully submitted,

PERCY W. PHILLIPS
Counsel for Petitioner

CERTIFICATE OF COUNSEL

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58(2) of the Rules of this Court.

PERCY W. PHILLIPS
Counsel for Petitioner

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 19,372

MAXWELL HARDWARE COMPANY, a corporation,
Petitioner on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

[Mar. 30, 1965]

On Petition to Review the Decision of the
Tax Court of the United States

Before: HAMLEY and MERRILL, Circuit Judges, and
THOMPSON, District Judge

THOMPSON, District Judge:

This is a petition for review of a decision of the Tax Court of the United States, jurisdiction of which is conferred on this Court under Title 26, U.S.C., § 7482. The Tax Court disallowed to Petitioner, Maxwell Hardware Company, a corporation, net operating loss carryover deductions taken for its tax years ending January 31, 1957 to 1960, inclusive.

In summary, the facts are that Maxwell Hardware had sustained approximately $1,000,000 of losses in a hardware business. It entered into an agreement with two partners, Beckett and Federighi, who were engaged in numerous real estate development activities as partners and controlling stockholders of corporations, whereby a real estate department was established in Maxwell Hardware to develop a subdivision, the funds therefor being furnished by the two partners through purchases of non-voting preferred stock in the corporation for an amount which was

approximately two-fifths of the then value of the common stock of the corporation. The real estate department was accounted for independently of the other corporate business. The agreement provided that the real estate department should not be discontinued for a period of six years, that the preferred stockholders should not sell their stock for this period, and thereafter, if the department were discontinued at the option of either the corporation or preferred stockholders, the preferred stock should be redeemed by distribution in kind of ninety per cent of the department's assets to the preferred stockholders. A voting trust agreement was established to restrict the control of the common stockholders over the corporation for a period of five years. The voting trust agreement did not, however, transfer such control to the new investors. The hardware business was discontinued and the real estate business (Bay-O-Vista Subdivisions) operated at a profit. The net operating losses which had been previously sustained by the hardware business were deducted as loss carryovers from the real estate profits. The agreement between the corporation and the new preferred stockholders was entered into on October 18, 1954, and was therefore governed by the provisions of Internal Revenue Code of 1954.

The transactions and events giving rise to this dispute are complicated and extensive. The Findings of Fact and Opinion of the Tax Court are published (Arthur T. Beckett v. Commissioner, 41 T.C. 386). Inasmuch as this decision will be of interest primarily to the tax bar, to whom the referenced publication is readily available, we see no justification in reprinting here the twelve odd pages of Findings of Fact there published. They are adopted by reference. Neither have we undertaken here to repeat in detail all the contentions and arguments discussed in the Tax Court Opinion. With one exception, the findings of the Tax Court have not been contested on this appeal. Petitioner complains that the finding that the "primary pur-

pose of Beckett and Federighi in entering into the agreement of October 18, 1954 with Maxwell Hardware was to enable the profits which they anticipated would be made in the development of the Bay-O-Vista Subdivision to be offset by net operating losses which had been sustained by Maxwell Hardware in prior years" is contrary to the evidence. We think the finding to be amply sustained by substantial evidence and not subject to review by this Court. United States v. First Security Bank (9 CCA 1964), 334 F. 2d 120, and cases there cited. Our review of the decision, therefore, is restricted to an interpretation and application of the law to the facts as found.

Preliminarily, we should note that in the Tax Court, three petitions for redetermination of deficiencies assessed by the Commissioner, involving the tax liabilities of Arthur T. Beckett and Gertrude E. Beckett, #93309, of Frederick J. Federighi and Mary Helen Federighi, #95310, and of Maxwell Hardware Company, #95311, arising out of the related transactions, were consolidated for trial on a single common fact issue. The Tax Court trial was a complete trial with respect to the tax liability of Maxwell Hardware Company, but only a partial trial with respect to the tax liability of the individuals, Becketts and Federighis. The common issue of fact consolidated for trial was whether the income of the real estate department of Maxwell Hardware Company should have been returned by Maxwell Hardware Company or by the partnership of Beckett and Federighi, and derivatively, by the partners individually. The Government contended that the transactions were a sham, and that the operation of the real estate business under the corporate cloak was pure subterfuge, without factual substance.

The Tax Court, relying upon substantial evidence, resolved this issue in favor of the bona fides of the transactions in the sense that they were not sham, that there was a genuine business purpose for using a corporation for the

real estate development enterprise, and that the resulting transactions were corporate actions of Maxwell Hardware, not actions of Beckett and Federighi carried on under a corporate name. The Tax Court held that the subdivision income was properly returned as the income of Maxwell Hardware Company. This conclusion is not excepted to by either party on this appeal and constitutes the foundation for our consideration of the case.

The reported opinion and decision of the Tax Court (Judge Scott) demonstrates careful and thorough analysis of the facts, understanding of the law, and clarity of expression. We do not, however, agree with the conclusions of the Tax Court in applying the law to the established facts.

APPLICABILITY OF THE LIBSON SHOP DOCTRINE

The Tax Court relied upon the decision of the Supreme Court in Libson Shops, Inc. v. Koehler, 1957, 353 U.S. 382. In that case, the transactions generating the tax liability occurred prior to the effective date of the 1954 Code. The issue there was "whether under §§ 23(s) and 122 of the Internal Revenue Code of 1939, as amended, a corporation resulting from a merger of 17 separate incorporated businesses, which had filed separate income tax returns, may carry over and deduct the pre-merger net operating losses of three of its constituent corporations from the post-merger income attributable to the other businesses." (Idem. 382). The Supreme Court denied the loss carry-over deduction, saying: "We conclude that Petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses." (Idem. 390). The Commissioner, the Tax Court and Petitioner all agree that if Libson Shops had arisen under the 1954 Code, the same decision could not have been made inasmuch as Section 381 of the 1954 Code would expressly allow the net operating loss carryover and the limitations of Section 382 would be inapplicable.

Whenever a Court adopts a rule of decision to sustain a conclusion, interpreting statutory law then applicable, and the legislative authority amends or changes the statutory law to the effect that the same decision could not be reached if the new statute were applied to the same facts, the case is not controlling precedent for judicial interpretation of the new law.[1] By enacting the 1954 Code, Congress destroyed the precedential value of the rule of decision of of Libson Shops; that is, that for a loss carryover deduc-

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[1] While we have found no enunciation of the principle of stare decisis in this exact language in the authorities, we think the statement is necessarily implied. 21 C.J.S. 318: "Where the law on a particular subject is radically changed or superseded by statute, decisions under the old law become of little value as authority." Helvering v. Hallock, 1940, 309 U.S. 106: "But stare decisis is a principle of policy and not a mechanical formula of adherence to the latest decision * * *." Great Northern Ry. Co. v. United States, 1942, 315 U.S. 262 (overruling the interpretation in the Stringham case of an 1875 Act of Congress): "The conclusion that the railroad was the owner of a 'limited fee' was based on cases arising under the land grant acts passed prior to 1871, and it does not appear that Congress' change of policy after 1871 was brought to the Court's attention. That conclusion is inconsistent with the language of the Act, its legislative history, its early administative interpretation and the construction placed on it by Congress in subsequent legislation. We therefore do not regard it as controlling." Helvering v. Griffiths, 1942, 318 U.S. 371 (where the Court was asked to overrule Eisner v. McComber): "Nothing in the history or attitude of this Court should give rise to legislative embarrassment if in the performance of its duty a legislative body feels impelled to enact laws which may require the Court to reexamine its previous judgments or doctrine. The Court differs, however, from other branches of the Government in its ability to extricate itself from error. It can reconsider a matter only when it is again properly brought before it in a case or controversy; *and if the case requires, as a tax case does, a statutory basis for a case, the new case must have sufficient statutory support.*" Patterson v. United States, 1959, 359 U.S. 495: "'[W]hen the questions are of statutory construction, not of constitutional import, Congress can rectify our mistake, if such it was, *or change its policy at any time* * * *.'" (Emphasis supplied.)

tion to be allowed, the income against which the offset was claimed must have been produced by substantially the same businesses which incurred the losses. This is not now the law. It seems to us irrelevant that Libson Shops was decided in 1957, long after the enactment of the 1954 Code. The Supreme Court, in Libson Shops, decided the case by deliberately interpreting and applying the Internal Revenue Code of 1939, as amended, and, while noting a minor change in the 1954 Code (Idem. 385, footnote 2), did not comment upon or consider how the case should be decided if the 1954 Code were applicable.[1a]

SECTIONS 172 and 382 LIMITATIONS

Recognizing the frailty of Libson Shops as a precedent for decision in this case, the Government suggests alternative bases to sustain the Tax Court. One is the contention that Section 172,[2] which establishes the net operating loss carryover deduction does not apply to Maxwell Hardware. The argument is that, viewed realistically, the transactions amounted to placing "two separately owned businesses entities under a single corporate roof", and that the net operating loss carryover deduction inures only to the business entity which generated it. As a matter of statutory interpretation, we find nothing in § 172 which justifies such a conclusion. We cannot disregard the finding of the Tax Court that Maxwell Hardware Company, a corporation, is the taxable entity in this case and that it is the entity which suffered the losses as well as generated

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[1a] In Sansome v. United States, decided March 29, 1965, the Supreme Court held its decision in *Achilli* v. *United States*, 1957, 353 U.S. 373, under the 1939 Code to be inapplicable to the same problem arising under the new treatment in the 1954 Code.

[2] § 172(a): "There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such a year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection."

the subsequent income sought to be taxed. The corporation is the "taxpayer" as defined in the Code [26 U.S.C., § 1313(b), § 7701(a)(1)(4)], and we see no justification for a judicial departure from the carefully devised and integrated concepts of the Code which would require a judicial recognition of a taxable entity or "taxpayer" different from those identified by Congress.

With respect to the limitations applicable to the deductibility of net operating loss carryovers, the Government says that the deduction is disqualified in this case by the special limitation provisions of Section 382(a).[3]

The Tax Court found Section 382(a) to be inapplicable, and we agree. The conditions of subsection (C) have been fulfilled, i.e., Maxwell Hardware did not continue to "carry on a trade or business substantially the same as that con-

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[3] § 382(a)(1): "Purchase of a corporation and change in its trade or business.—

"In General.—If, at the end of a taxable year of a corporation—

"(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

"(i) the beginning of such taxable year, or

"(ii) the beginning of the prior taxable year,

"(B) the increase in percentage points at the end of such taxable year is attributable to—

"(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

"(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

"(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted

ducted before any change in the percentage ownership of the fair market value" of the stock. It is also clear, however, that these complicated transactions did not result in persons, as defined, owning fifty percentage points more of the total fair market value of the outstanding stock of such corporation than theretofore. The Tax Court found that the stock acquired by Beckett and Federighi was "nonvoting stock which is limited and preferred as to dividends" [26 U.S.C. § 382(c)], and said: "It is clear that the issuance of the preferred stock to Beckett and Federighi does not come within any of these provisions." (T.C. 417). Its concise statement of the problem remaining is (T.C. 417): "The problem is whether by specifying the various circumstances in section 382 in which net operating loss deductions would be disallowed in whole or in part where a change in stock ownership has occurred followed by a change in corporate business, Congress intended to provide that in all other instances the loss corporation would be entitled to deduct its net operating loss carryover from earnings from a different business enterprise unless such deduction fell within the prohibition of section 269." We disagree with the Tax Court's negative answer to this inquiry. We conclude from the legislative history that it was the clearly expressed intention of Congress to attempt to bring some order out of chaos, and, in effect, to countenance "trafficking" in operating loss carryovers except as affected by the special limitations of Section 382 and the general limitations of Section 381. (Other Code sections, such as Section 269, are disregarded in this discussion and will be hereinafter considered separately).

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before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years."

By adopting Section 172(a), Congress created a net operating loss deduction, applicable to taxpayers generally. In Section 381, Congress dealt specifically with the transfer of a variety of deductions, including net operating loss carryovers [Sec. 381(c)(1)] in cases of corporate reorganizations and acquisitions; and in Section 382, Congress provided special limitations by careful and specific definition upon the right to take a net operating loss carryover deduction where there had been a change in ownership of the corporate stock and a change in the corporation's trade or business. Section 172 is a substantial revision of Section 122 of the 1939 Code. U.S. Cong. & Adm. News, 1954, Vol. 3, p. 4192 (House Report), p. 4847 (Senate Report). Sections 381 and 382 are entirely new, and had no counterpart in the 1939 Code. Idem. pp. 4273, 4281 (House Report); pp. 4914, 4922 (Senate Report). We cannot ascribe to a Congress which, after years of thorough and careful committee consideration aided by the solicited advice of the finest students of taxation, has adopted a fully integrated revenue code, the intention that its provisions should be lightly disregarded by the courts. Neither can we conclude that new and unanticipable judge-made rules are contemplated by a Congress which declares: "As a result, present practice rests on *court-made law* which is *uncertain* and frequently *contradictory*. Moreover, whether or not the carryover is allowed should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization" (emphasis added), Idem. p. 4066 (House Report), p. 4683 (Senate Report). The Reports respecting Section 382 even more clearly demonstrate Congressional intent to substitute statutory rules for judge-made law.[4] It is quite unlikely that the stated

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[4] House Report, p. 4067:

"Under present law where a controlling interest in a corporation is acquired for the purpose of avoiding or evading tax liabilities the Internal Revenue Service may disallow the benefits of a deduc-

purposes of certainty, consistency and objectivity are to be achieved if each court considering a loss carryover problem adds a gloss of judicial exceptions reflecting what a particular judge or group of judges thinks Congress should have done, rather than what it did. An expression like "trafficking in loss carryovers" is a question-begging epithet which clouds reason. A dispassionate considera-

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tion, credit, or allowance which would otherwise be enjoyed by the acquiring person or corporation. This provision has proved ineffectual, however, because of the necessity of proving that tax avoidance was the primary purpose of the transaction. It has also been so *uncertain* in its effects as to *place a premium on litigation* and a *damper on valid business transactions.*

"The committee added a provision designed to limit undue tax benefits of this character by restricting the amount of net operating loss carryover which may be deducted where 50 percent or more of the participating interest in a corporation was acquired by new owners. In such cases the net operating loss carryover to the current and subsequent taxable years is to be reduced by the percentage of new ownership acquired either by purchase or by decrease in the participating stock outstanding. This provision does not apply to publicly held corporations.

"This special limitation on net operating loss carryovers *provides an objective standard* governing the availability of a major tax benefit which has been abused through trafficking in corporations with operating loss carryovers, the tax benefits of which are exploited by persons other than those who incurred the loss. It treats a business which experiences a substantial change in its ownership, to the extent of such change, as a *new entity* for tax purposes." (Emphasis added.)

Senate Report, p. 4684:

"Your committee has adopted a provision to limit the application of this provision relating to purchase to those areas in which abuse has most often arisen, that is, the purchase of the stock of a corporation with a history of losses for the purpose of using its loss carryovers to offset gains of a business unrelated to that which produced the losses. Accordingly, your committee has provided that if more than 50 percent of the stock of a corporation is purchased within a 2-year period and if the corporation thereafter engages in a different type of business, then the loss carryover is eliminated."

tion of the 1954 Code must lead to the conclusion, we believe, that Congress has deliberately sanctioned such so-called "trafficking" in those situations where it is not expressly abjured.

This is not to say that the language of the 1954 Code is to be given a sterile, mechanical, literal application. The courts must give sense and vitality to that language, but this must be done within the framework of the Code to achieve the Congressional design.

APPLICABILITY OF SECTION 269

As a second alternate basis for affirmance, the Government invokes the applicability of Title 26, U.S.C., § 269.[5] Subsections (a) and (b) of this Section were carried forward from Section 129 of the 1939 Code. Subsection (c), providing a presumption of wrongful purpose in certain circumstances was added by the 1954 Code. U.S. Cong. &

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[5] Title 26, U.S.C., § 269:

"Acquisitions made to evade or avoid income tax

"(a) In general.—If—

"(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

"(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose of which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

Adm. News, 1954, Vol. 3, p. 4057 (House Report). The new presumption is of no interest here as the Tax Court found that the Maxwell Hardware acquisition by Beckett and Federighi was made for the avoidance of Federal income tax by securing the benefit of the net operating loss deduction. Just as Section 382(a) requires more than proof of a substantial change in the trade or business conducted to disqualify the deduction, so does Section 269

"(b) Power of Secretary or his delegate to allow deduction, etc., in part.—In any case to which subsection (a) applies the Secretary or his delegate is authorized—

"(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

"(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determined will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

"(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

"(c) Presumption in case of disproportionate purchase price.—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

"(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the property acquired specified in paragraph (2) of subsection (a); and

"(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954."

require more than proof of a purpose to evade or avoid taxes. The additional requirement is the acquisition directly or indirectly of control of a corporation, specifically, the ownership of stock possessing at least fifty per cent of the voting power or at least fifty per cent of the total value of shares of all classes. The purchase by Beckett and Federighi of preferred shares for $200,000 of a corporation whose common shares were found to have a fair market value of $500,000 on its face did not satisfy the requirement of acquisition of fifty per cent of the total value of the shares outstanding, and there is nothing in this record which would justify a conclusion that the true fair value of the preferred shares at the date of acquisition exceeded the amount paid therefor.

Invoking Section 269, the Government argues that the complex transaction between Maxwell Hardware and Beckett and Federighi, viewed realistically, resulted in the indirect acquisition by Beckett and Federighi of fifty per cent of the total combined voting power of the corporation. An integral component of the entire transaction was the voting trust agreement which, although not mentioned in the basic agreement of October 18, 1954, bore even date therewith. The agreement created an irrevocable voting trust of all the common shares of Maxwell Hardware until January 31, 1961 and invested the trustee, The San Francisco Bank, with all voting rights, limiting its authority only in respect of the selection of the Board of Directors. The agreement required the trustee to vote for T. P. Coates, an officer of the Bank, and John M. Bryan, as two members of the three man board. The trustee's selection of the third member was unfettered. The agreement accomplished a relinquishment by the common stockholders of their voting control; but the condition for the invoking of Section 269 is the acquisition by persons (here, Beckett and Federighi) of fifty per cent voting control. This is an integrated voting trust agreement which con-

trolled the trustee's powers and responsibilities. It cannot fairly be construed as an acquisition by Beckett and Federighi of any voting control.

True, the evidence proved and the Tax Court found that it was understood that Federighi would be the third director of Maxwell Hardware (T.C. 399), and that there was an oral agreement that Bryan would not be vetoed on any reasonable business investment he wished to make on behalf of Maxwell Hardware. Such evidence was probative and relevant on the issue of sham, an issue which has been permanently resolved against the Government, and on the issue under Section 269 of purpose to evade or avoid, an issue which has been conclusively determined against Petitioner, Maxwell Hardware. Such evidence, however, does not, in our view, justify an inference, as the Government asserts, that fifty per cent voting control was thereby acquired by Beckett and Federighi. A voting trust agreement is too valuable a vehicle for the effectuation of innumerable commercial transactions to be thus lightly impugned; and the eagerness of the Commissioner to collect taxes, a duty imposed on him by law, should not lead the courts arbitrarily to disregard established and useful forms of business relationships. The voting trust agreement invested the voting control in the trustee, not in Beckett or Federighi. If the evidence were such as to justify a finding that under all the circumstances, either the trustee bank or T. P. Coates, a designated director, was under the domination and control of Beckett and Federighi, the case would be different. There is no such evidence. The Tax Court correctly said: "We think it clear that the provisions of Section 269 are not applicable here because of the absence of the type of acquisition provided for therein." (T.C. 414).

APPLICABILITY OF SECTION 482

Congress has given discretionary authority to the Secretary of the Treasury in certain situations:

> "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

The Government, in its arguments based on Sections 382 (a) and 269, infra, has repeatedly reemphasized that under the carefully designed legal relationships established by these facts, two separate businesses owned and managed by separate interests were being conducted under one corporate roof.

The Tax Court found that the transactions were not a sham, that Maxwell Hardware was the corporate taxpayer, and that the subdivision profits were the taxable income of Maxwell Hardware.

With respect to the tax liability of Maxwell Hardware, no reliance may be placed on Section 482 to justify a decision because the Commissioner did not rely upon it and gave no notice of such issues in his Notice of Deficiency to Maxwell Hardware. United States v. First Security Bank (9 CCA 1964), 354 F. 2d 120; Comm. v. Chelsea Products (3 CCA 1952), 197 F. 2d 620; Ross v. Comm. (5 CCA 1942), 129 F. 2d 310.

Section 482 was, however, mentioned in the Tax Court opinion: "Although respondent in his notice of deficiency[6]

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[6] The notice of deficiency referred to in this quotation is the notice to the individuals, Becketts and Federighis, not to Maxwell Hardware Co.

referred to section 482 of the Internal Revenue Code of 1954, he does not argue the application of this section and in effect concedes that unless the transfer of the Bay-O-Vista land to Maxwell Hardware is considered a sham, section 482 is inapplicable in this case." And we have not alluded to it in this case just to raise a strawman and then blow him down. Sometimes plain statutory language is distorted by courts to achieve what appears to be a just result in a particular case. The Government seeks to have this Court do that with respect to Sections 172, 382 and 269 to attain what it deems to be the just result in this case. We decline to do so, and to justify ourselves to the faint-hearted, we wondered whether Congress actually did leave the Commissioner helpless in this situation.

The opening statements of counsel before the Tax Court show that the Commissioner did rely upon Section 482 in his notices of deficiency to the Becketts and Federighis as individual taxpayers. Congress has not defined the meaning of "owned or controlled" under Section 482 as it has in Sections 382(a) and 269, and a broad definition has been adopted in the Regulations [Regs. 1.482-1(a)(3)]:

> "The term 'controlled' includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted."

It is arguable that the combination of factors in this case, such as the basic agreement, the preferred stock, the management contract with Federighi, the voting trust, the election of Federighi to the board of directors, the carefully drafted dissolution provisions allocating ninety per cent of the subdivision profits to the preferred stock, are sufficient to justify a conclusion that the subdivision business of Maxwell Hardware was controlled by Beckett and Federighi if the Commissioner, in his discretion, had pro-

erly so determined [Cf. Dillard-Waltermine Inc. v. Campbell (5 CCA 1958), 255 F. 2d 453; National Securities Corp. v. Comm. (3 CCA 1942), 137 F. 2d 600; Rooney v. United States (CCA 1962), 305 F. 2d 681; Comm. v. Chelsea Products, supra], and if the Commissioner had also properly determined that it was necessary to allocate ninety per cent of the subdivision income to the individuals to "prevent evasion of taxes" (Sec. 482).

This, however, is not an issue before this Court on this petition for review and our comment is only a comment and not a judgment.

Nor do we suggest that the Section 482 issue is still alive in the Tax Court's consideration of the petitions for redetermination of the individual taxes of the Becketts and Federighis. The opening statements before the Tax Court make it clear that the consolidated trial before the Tax Court would definitely determine the common issue of whether the subdivision income was properly taxable to the corporation or to the individuals, and both parties on this appeal have accepted the Tax Court determination that the subdivision income was properly taxable to Maxwell Hardware.

SUMMARY

This decision is reached in a straightjacket.[7] We are bound by the Tax Court finding that the Maxwell Hardware transaction was a bona fide business transaction creating substantial, and not illusory, business relationships. We are concerned only with the tax liability of Maxwell Hardware, which, the Tax Court found, properly

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[7] Prior to the reception of evidence in the Tax Court, Judge Scott expressed her opinion that it was "very unsatisfactory" to try all of one case and only part of others in a consolidated trial involving alternative claims with respect to determination of the taxpayer to whom taxable income should be assigned. We agree. Judge Scott deemed herself bound by the order of consolidation earlier entered by another judge on stipulation of counsel.

reported as its income the profit from the subdivision business. We are faced only with the problem of whether the net operating loss deduction generated by the hardware business may be taken against the income from its subdivision business.

The Tax Court considered this a special case, and said: "In so holding, we do not intend to establish a broad legal principle but merely to apply already established principles to an unusual factual situation." We think special cases are to be processed under Section 482 if applicable.

Libson Shops, decided under the 1939 Act, is no longer law. It has been superseded by the 1954 Internal Revenue Code which, in Section 382, dealt specifically and differently with the concept of continuity of business enterprise upon which the Libson Shops decision was based.

Taxation is peculiarly a matter of statutory law, and in applying that law to the determination and computation of income and deductions, the Courts do not make moral judgments. There is nothing perfidious or invidious in enjoying a statutory deduction from reportable income. It is not a matter of conscience but of statute and the determination of Congressional intent. In our opinion, Congress has quite plainly said that net operating loss deductions should be allowed unless the special circumstances interpreted within the letter and spirit of Sections 382(a) and 269 obtain. The conditions disallowing the deduction have not been established here. It is of much more importance that businessmen, accountants, lawyers and revenue agents should retain confidence that plain statutory language means what it says and what it reasonably implies than that a particular deficiency assessment should be sustained. We cannot, within the statutory framework applying a fair and reasonable interpretation to the language used, disallow to Maxwell Hardware the net operating loss deduction.

The decision of the Tax Court is reversed.